CREATING A CANADIAN ADVANTAGE
IN GLOBAL CAPITAL MARKETS

ASPIRE

TO A STRONGER, SAFER, BETTER CANADA

CANADA'S NEW GOVERNMENT

BUDGET 2007

MARCH 19, 2007

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Foreword by the Minister of Finance

Strong and vibrant capital markets are essential for economic growth and prosperity in Canada.

Changes to the world economy have implications for all Canadians. Money and talented people are flowing across borders as never before. Competition for investment is fierce. To keep pace with this rapid global change, we need a fresh approach to achieve a Canadian advantage in global markets.

First, we need to modernize fragmented and complex laws that govern our markets. We must adopt a clear set of principles for businesses—one that is tailored to the unique makeup of Canada's capital markets. This would be best overseen by a common securities regulator that gives all regions of our country a voice. These steps would reduce costs and strengthen our markets.

Second, we need to protect the investments of Canadians. To do so, we must provide the highest standards of corporate governance, enforce our laws vigorously and tackle white-collar crime.

Third, Canadians need better access to investment opportunities. We must pursue free trade in securities so Canadians can more easily buy foreign securities, and so foreign investors can more easily invest in Canada. Our country is spearheading discussions with the United States and other Group of Seven (G7) countries to achieve these goals.

Finally, Canadians must have the information they need to make sound financial decisions. This requires that they have the financial literacy to understand rewards and risks, an essential skill that should be developed early. It also means less fine print and more plain-language disclosure.

How does all this affect ordinary Canadians? Improving our capital markets will cut costs and increase returns. Thanks to compound interest, this adds up. Even a fraction of a percentage point increase in investment returns over the course of a working career can add to thousands of dollars to a typical Canadian's retirement savings.

That's not all. Businesses will get better access to financing at lower costs, while Canada's leading-edge financial sector will generate more highly skilled, well-paying jobs.

For some parts of this plan, Canada's New Government can act alone. Others require the active cooperation of our partners in the provinces and territories, which have already made welcome progress in streamlining regulations, as well as the business and the investment communities.

Increased protection and income for investors, better jobs, more investment and prosperity: that is what our Capital Markets Plan will achieve for Canadians.

Executive Summary

When companies raise money, and when Canadians invest their hard-earned savings, they rely on capital markets. In *Advantage Canada*, Canada's New Government committed to securing a competitive advantage in global capital markets. The objectives are to give enterprises of all sizes better access to capital at more competitive costs, provide investors with increased investment choices, and create more highly skilled, well-paying jobs in financial services.

Canada historically has benefited from vibrant, competitive capital markets. With the mobility of talent and capital and ever-intensifying global competition, developing leading-edge principles and rules to govern our capital markets is key to creating and sustaining a Canadian advantage.

The pursuit of a Canadian advantage requires the participation of all parties engaged in the regulation and business of capital markets, including provincial and territorial governments and the private sector.

To mobilize efforts, Canada's New Government puts forward a plan with four building blocks.

1. **Enhancing Regulatory Efficiency:** A new approach to securities regulation is proposed, one that is based more on principles and tailored to the unique makeup of Canada's capital markets, with both Canada-based global corporations and a large number of small and medium-sized issuers. A move to proportionate, more principles-based regulation will be a significant undertaking that would be difficult to achieve under the current, fragmented structure of securities regulation. A common securities regulator will create the opportunity to deliver this new approach. It will help improve investor protection, cut red tape, reduce costs for market participants and give an equal voice to all participating jurisdictions. The plan also proposes to modernize the legal framework for financial transactions.

2. **Strengthening Market Integrity:** Investor protection will be enhanced by pursuing the highest standards of governance and by enforcing our laws more vigorously. Enforcement will be bolstered with better resources to tackle cases of capital markets fraud and stronger collaboration with provincial authorities. A senior expert advisor to the RCMP will be appointed to help develop and guide the implementation of a plan to improve the effectiveness of the Integrated Market Enforcement Teams.

3. **Creating Greater Opportunity for Businesses and Investors:** Competition and choice for businesses and investors will be enhanced by pursuing free trade in securities with the United States and other Group of Seven (G7) countries. The plan also proposes to consolidate the debt issuance of some of the major financial Crown corporations with the Government's debt program to reduce overall borrowing costs and improve the liquidity of the government securities market.

4. **Improving Investor Information:** The plan will promote financial literacy, particularly for young Canadians, by developing new financial education materials. The plan will also improve investor information by introducing a new principles-based disclosure regime for bank investment products with complex features.

A Canadian advantage can build on positive steps taken in recent years by the full range of partners, including provinces and securities regulators. In some cases, this plan puts forward detailed measures Canada's New Government may move forward alone. In others, it proposes to partners a general direction and invites collaboration. The Minister of Finance will propose this plan to his provincial and territorial colleagues and looks forward to establishing with them targets and a timeline to realize a Canadian advantage in global capital markets.

Objectives

In *Advantage Canada*, Canada's New Government presented a strategic, long-term economic plan to improve our country's prosperity both today and in the future. The plan will strengthen Canada and show a modern, ambitious and dynamic country to the world.

Advantage Canada stated that a strong economy requires a leading-edge financial system that instills confidence and efficiently provides a wide range of financial services to households and businesses. Capital markets are an essential component of a strong financial system. This paper builds on the principles of *Advantage Canada* and puts forward a plan to create a Canadian advantage in global capital markets.

The objectives of this plan are to give enterprises of all sizes better access to capital at more competitive costs; provide investors with increased investment choices and better protections; and create more highly skilled, well-paying jobs in a globally competitive financial services industry. In sum, a Canadian advantage in capital markets will achieve greater employment and prosperity for Canadians.

Canada historically has benefited from vibrant, competitive capital markets. This has been founded on a number of key strengths:

- An open economy that has embraced global trade and investment to drive economic growth and leverage the benefits of our proximity to the United States.
- A sound and competitive financial system that has facilitated the allocation of savings and investment in the economy.
- A solid market infrastructure, including the application of leading-edge technology in our exchanges and clearing and settlement systems.
- A strong base of managerial and professional talent and skills in such disciplines as finance, accounting and law.
- A mix of public and private institutional investors that have helped broaden the base of investment opportunities for Canadians.

- An entrepreneurial tradition, with a steady stream of professionals gaining experience in the larger broker-dealer or investment firms and then starting smaller, innovative specialized firms.
- Collaboration among regulators and the private sector in developing Canadian solutions to capital market issues in a manner that is also responsive to global developments.

Correspondingly, Canada has well developed capital markets. The Toronto Stock Exchange (TSX) is the seventh largest in the world in terms of market capitalization. In some sectors, Canada is among world leaders. For example, 60 per cent of the world's mining companies and 50 per cent of oil and gas companies are listed on the TSX or TSX Venture Exchange.

Canada's global ranking cannot be taken for granted. Capital markets and the highly skilled professionals who work in those markets are more mobile than ever. The principles and rules that govern our capital markets increasingly affect the location of investment and opportunities for our investors and firms. Other key jurisdictions—the United States, the United Kingdom, Asian economies and Australia—are developing concerted strategies to enhance the competitiveness of their capital markets. Canada must act now to further develop vibrant capital markets that serve the needs of Canadian businesses, investors and the economy.

A Canadian advantage can be created by establishing a first-class regulatory structure; meeting the highest standards of market integrity; broadening opportunities for investment, notably by pursuing free trade in securities; and fostering enhanced financial literacy and more effective disclosure so investors make informed choices.

Developing an advantage does not rest on a single set of measures. It must be founded on a sustained commitment. Global competition will not stand still. Canada must be nimble and responsive to achieve success.

Capital markets are an area of shared jurisdiction in Canada. The pursuit of a Canadian advantage requires the participation of all parties engaged in the regulation and business of capital markets. This includes the federal and provincial-territorial governments, their regulatory agencies and law enforcement bodies, self-regulatory organizations, standard-setting bodies and professional and industry associations, and market participants, including issuers, investors and intermediaries.

A Canadian advantage will build on our strengths and on positive steps taken in recent years by the full range of partners, including provinces and securities regulators, which increasingly have become aware of the need to act in concert to streamline regulation, protect investors and enhance market efficiency. It can also draw on the proposals of private sector expert groups, including the Crawford Panel on a Single Canadian Securities Regulator (the Crawford Panel) and the Task Force to Modernize Securities Legislation in Canada, sponsored by the Investment Dealers Association of Canada (the Allen Task Force).

For some initiatives set out here, Canada's New Government will be able to move forward alone. In other areas, the plan calls on all governments and capital market participants to pursue shared objectives and strengthen Canada's economic union. The Minister of Finance will propose this plan to his provincial and territorial colleagues and looks forward to establishing with them targets and a timeline to realize a Canadian advantage in global capital markets.

A Capital Markets Plan Founded on Canada's Five Advantages

Advantage Canada **put forward the advantages:**

Fiscal Advantage:

- Creates the right conditions for capital markets to grow by enhancing macroeconomic stability and strengthening Canada's net foreign asset position.

Infrastructure Advantage:

- Provides the modern infrastructure for financial centres to function competitively. In addition, new public-private partnerships for infrastructure projects increase the variety of investment products available to Canadians.

Entrepreneurial Advantage:

- Through a modern and effective regulatory framework, supports an efficient, modern and competitive economic environment for Canadian capital markets.

Knowledge Advantage:

- Encourages Canadian top talent to remain in the country and entices global talent to work and stay in Canada, a critical requirement for a competitive financial services industry.

Tax Advantage:

- Promotes higher savings and investment. Through a reduction in taxes and an increase in disposable income, individuals will have more resources and greater incentives to invest. Through competitive business taxation, new investment opportunities will be created in Canada, further stimulating capital markets. Furthermore, efficient and fair taxation will ensure that the decisions of issuers and investors are driven more by underlying business considerations and less by tax considerations.

The Importance of Capital Markets to Canadians

Capital markets are where financial securities issued by businesses and governments are bought and sold. Financial securities include stocks, bonds, derivative contracts and many other tradable investment products. These transactions take place on organized exchanges such as the Toronto Stock Exchange, the Montréal Exchange, the Winnipeg Commodity Exchange, and the NGX (an energy exchange based in Calgary) and directly between buyer and seller ("over the counter") in financial markets across Canada.

Importance for Canadian Investors

Canadians are rapidly accumulating financial assets. A 2004 Toronto Stock Exchange survey found that about half of all Canadian adults own shares, either directly or through mutual funds. According to a Statistics Canada survey conducted in 2005, Canadian households own almost $2 trillion in financial assets. This includes almost $600 million held in individual registered retirement accounts and over $1 billion in employer-sponsored pension plans. An additional $140 billion of assets are managed on behalf of working Canadians and pensioners by the Canada Pension Plan Investment Board and the Caisse de dépôt et placement du Québec.

The retirement income of Canadians (including the majority who do not have a defined benefit pension plan) depends importantly on opportunities to invest these savings efficiently. Investment returns are enhanced when Canadians can invest in financial securities quickly and easily with low transaction costs on an informed and well-protected basis. Even a small enhancement in annual investment returns translates into substantial wealth accumulation over a working career.

Supporting the Growth of Retirement Savings

A Canadian advantage in global capital markets can help Canadians grow their retirement savings by increasing their investment returns.

- More efficient domestic capital markets will mean lower transaction costs and fees.
- Effective governance and enforcement will enhance protection for investors, reducing risk.
- Increased access to global capital markets and a wider range of investment instruments will provide greater opportunities to earn higher returns.
- Better financial literacy and disclosure will enable Canadians to make more informed investment choices.

Through the power of compounding, even a small increase in average investment returns translates into significant additional wealth over the course of an individual's working career. For example, for an investor contributing $2,000 per year in a registered retirement savings plan (RRSP) for 35 years, a one-quarter of one percentage point (25-basis-point) increase in the annual rate of return would yield an additional $10,000 in retirement assets.

Importance for Canadian Businesses

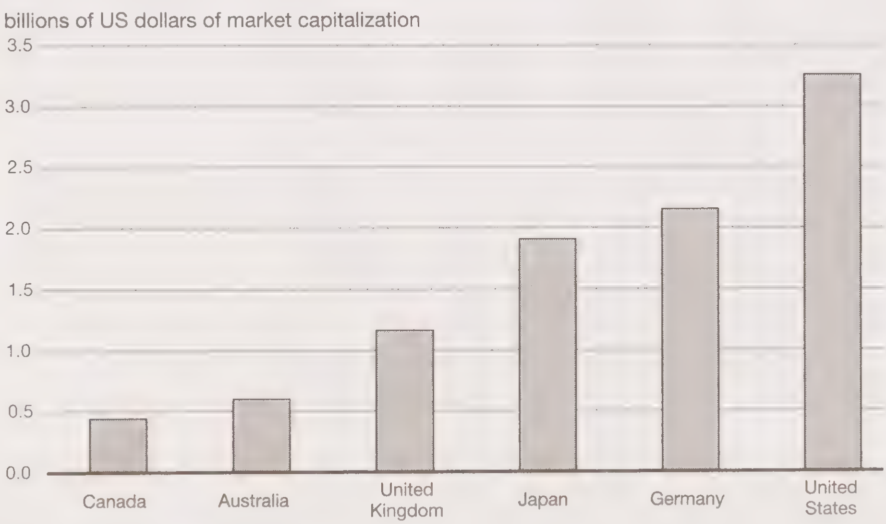
Canada has almost 3,800 publicly-listed companies, far more per capita than many other developed countries. For example, the U.S., with a population nine times that of Canada, has 5,100 listed companies. The average size of a Canadian listed company is smaller than in other countries (Chart 1). Small and medium-sized enterprises (SMEs) have relatively limited access to foreign capital markets, so they depend on domestic capital markets for cost-effective debt and equity financing for growth and expansion.

Larger, more established Canadian companies can access global capital markets for a portion of their funding needs. However, most still rely on domestic capital markets for the majority of their funding needs and derivative instruments for risk management. Thus, the more liquid and efficient are domestic equity and bond markets, and the wider the range of Canadian derivative instruments, the lower the cost of raising capital for Canadian businesses of all sizes.

Chart 1

Average Size of Publicly-Listed Companies

(As of December 2006)



Source: World Federation of Exchanges.

Today, studies suggest it costs more for Canadian companies to raise money than for comparable companies in the U.S.[1] This increases the cost of investment, placing Canadian companies at a competitive disadvantage.

Importance for the Economy

Considerable evidence shows that countries with the most developed financial sectors and capital markets enjoy the strongest economic growth over the long run.[2] Capital markets facilitate the efficient allocation of savings to where it is most productive. They allow large numbers of investors to reduce their financial risks through diversification. By spreading risk widely, they also cushion the economy against economic and financial shocks.

Capital markets also help create good jobs and spinoff benefits, with average wages in the sector exceeding the average industrial wage by almost 30 per cent. These jobs are particularly important to the economies of Canada's financial centres, including Calgary, Toronto, Montréal and Vancouver.

Competition From Foreign Markets

Canada's capital markets represent a small share of a huge global capital market where capital is increasingly mobile. Consequently, Canadian companies seeking capital and Canadian investors purchasing securities have many alternatives to the domestic market.

Many Canadian companies raise money on both domestic and international capital markets. For example, as of October 2006, 232 companies listed on the TSX were also listed on foreign exchanges. At the same time, the TSX included 119 foreign companies among its 1,584 listed companies. Through alliances, mergers, acquisitions and other corporate strategies, exchanges throughout the world are positioning themselves to benefit from growing international financial transactions and competition.

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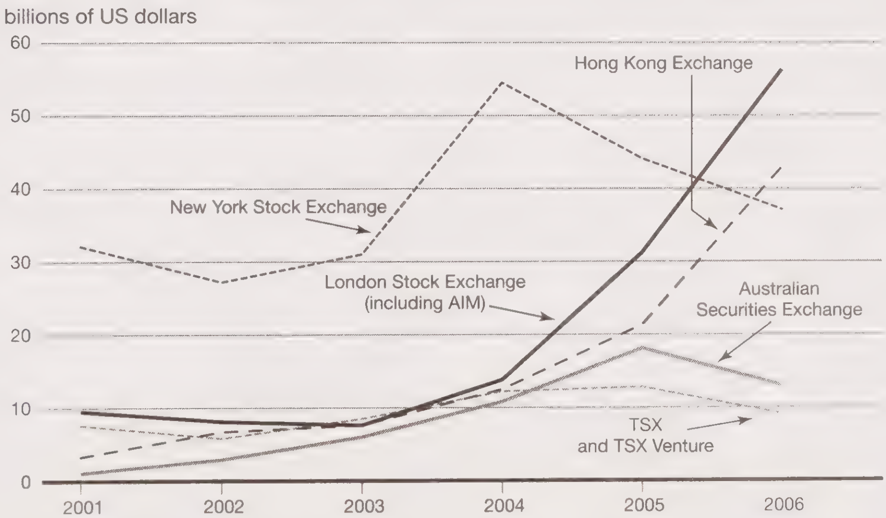
1 Bhattacharya, Utpal, "Enforcement and its Imapct on Cost of Equity and Liquidity of the Market," May 2006 study commissioned by the Allen Task Force. See also: Hail, L., and C. Leuz, "International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?", Working Paper, Wharton School (2005).

2 Leahy, M., S. Schich, G. Wehinger, F. Pelgrin and T. Thorgeirsson, "Contributions of Financial Systems to Growth in OECD Countries," Economics Department Working Paper No. 280, Organisation for Economic Co-operation and Development. 2001. See also: Beck, T., and R. Levine, "Stock Markets, Banks, and Growth: Panel Evidence" (May 2002).

Globally, competition for securities listings, investment dollars and professional talent is intense. The largest exchanges are seeking to extend their size and global reach through strategic alliances and acquisitions while reducing costs. Technological innovation increases the speed of financial transactions and intensifies competition.

National governments from the United States to the United Kingdom and Australia are developing strategies to attract issuers, investors and other capital market participants. The U.K. has distinguished itself and has attracted a large share of international business to London with pragmatic, principles-based regulation. In 2006, new equity issues in the U.K. almost doubled, exceeding the level in the U.S. Established financial centres in North America and Europe are also facing growing competition from other financial centres, including Hong Kong and Sydney, Australia. To date, while Canada has achieved a stable performance in dollar terms—e.g. as measured by initial public offerings on the TSX—other jurisdictions have been more succesful in growing their business (Chart 2).

Chart 2
Initial Public Offerings on Major International Exchanges



Source: World Federation of Exchanges.

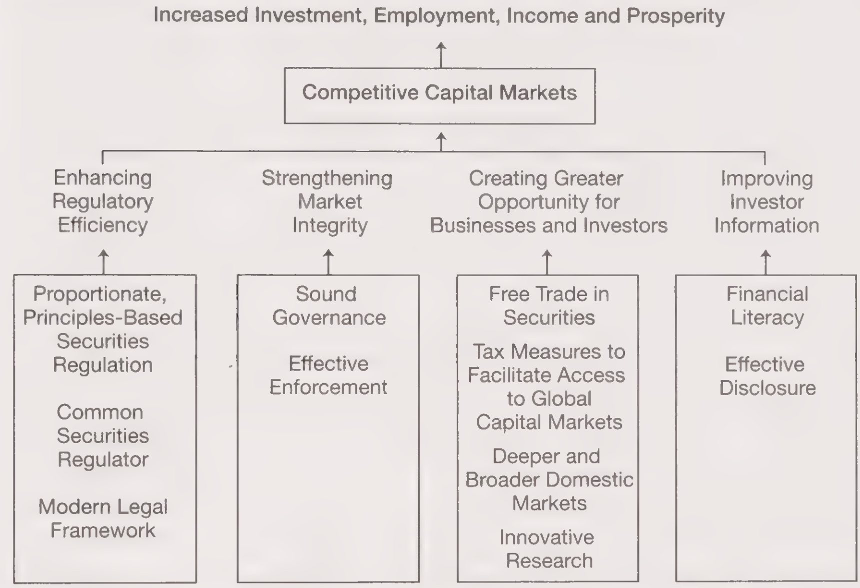
The Capital Markets Plan

As illustrated in Chart 3, the Capital Markets Plan is based on four building blocks to create a Canadian advantage in global capital markets.

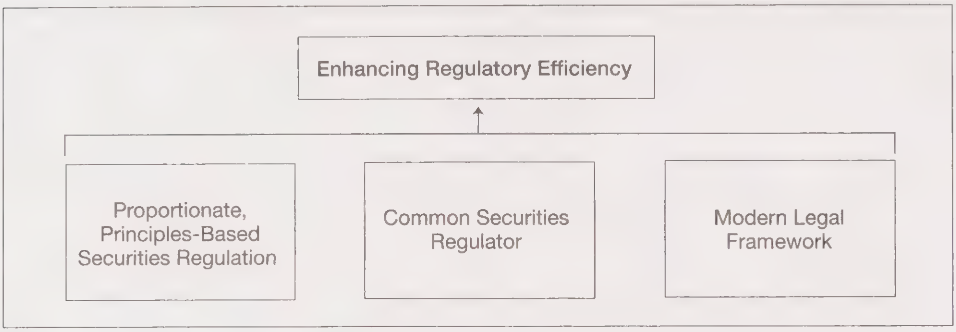
The building blocks are:

- **Enhancing Regulatory Efficiency**—Moving toward proportionate, more principles-based regulation under a common securities regulator and establishing a modern legal framework for financial transactions.
- **Strengthening Market Integrity**—Pursuing the highest standards of governance and bolstering enforcement, with better resources to tackle cases of capital market fraud and stronger collaboration with provincial authorities.
- **Creating Greater Opportunity for Businesses and Investors**—Enhancing competition and choice for businesses and investors by pursuing free trade in securities with the United States and other G7 countries and ensuring efficient domestic markets.
- **Improving Investor Information**—Working with partners so that Canadians have the financial literacy and information they need as they increasingly manage their own financial affairs.

Chart 3
Creating a Canadian Advantage in Global Capital Markets



Enhancing Regulatory Efficiency



Proportionate, Principles-Based Securities Regulation

As stated in *Advantage Canada*, modern and effective regulation is the foundation for an innovative and prosperous economy. This applies especially to Canada's capital markets. This plan sets out proposals to increase regulatory efficiency by moving towards common, proportionate, principles-based securities regulation for the benefit of issuers, investors and intermediaries.

Canadian capital market participants are now governed by a complex web of laws and regulations. Complying with these rules raises the cost of financing in Canada unnecessarily. Both Canadian businesses and foreign issuers may be discouraged from going public in Canada as a result of rules that are too burdensome for their situation.

Canada can pursue an advantage through a less complicated and more flexible system of securities regulation, founded on sound principles and supplemented by clear and effective rules that are proportionate to the different needs and capacities of small and large firms.

Canada can look to the experience of the United Kingdom's Financial Services Authority (FSA), which has committed itself to moving regulation gradually away from detailed rules toward a more principles-based approach. Founding principles are simple and clearly laid out. For example, the Authority has adopted 11 simple principles to govern the behaviour of the firms it regulates. The FSA is also working to pare down its rulebook to make it less detailed and prescriptive. This approach is widely credited for having contributed to the recent success of the City of London in its competition with New York and other centres for global financial business.

United Kingdom Financial Services Authority
11 Principles of Business

1. **Integrity**—A firm must conduct its business with integrity.
2. **Skill, care and diligence**—A firm must conduct its business with due skill, care and diligence.
3. **Management and control**—A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. **Financial prudence**—A firm must maintain adequate financial resources.
5. **Market conduct**—A firm must observe proper standards of market conduct.
6. **Customers' interests**—A firm must pay due regard to the interests of its customers and treat them fairly.
7. **Communications with clients**—A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.
8. **Conflicts of interest**—A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9. **Customers—relationships of trust**—A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.
10. **Clients' assets**—A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. **Relations with regulators**—A firm must deal with its regulators in an open and co-operative way and must disclose to the FSA anything relating to the firm of which the FSA would reasonably expect notice.

Principles are clear outcomes that market participants have the responsibility to achieve based on their circumstances. Shifting towards regulation based more on principles will be a gradual process and an ongoing exercise in balance. It will require the commitment and cooperation of market participants, regulators and governments. Market participants will have more responsibility to integrate the principles into decision making and more discretion in choosing how to do so. Regulators and governments will be responsible for spelling out the principles clearly, giving guidance and ensuring consistency in interpretation and application.

This does not imply a weakening of regulatory standards. Indeed, principles can underpin the highest standards. Moreover, strong enforcement will be imperative to ensure that principles are applied effectively to protect investors.

A securities regulatory regime for Canada must be tailored to the unique makeup of our capital market, with both Canada-based global corporations and a large number of small and medium-sized issuers.

Proportionate or tiered regulation is not new. It has been used in certain areas of securities regulation in Canada and elsewhere. Regulation tailored by size or market capitalization would give issuers the opportunity to innovate, grow and develop in their chosen markets, without being stifled by overly complex rules. This would be particularly beneficial to such issuers as high-technology start-ups and junior oil and gas and mining companies.

Moving towards more principles-based regulation is consistent with the recommendations put forward in October 2006 by the Allen Task Force, and has been endorsed by the Investment Industry Association of Canada. It accords with the commitment of Canada's New Government to a new performance-based regulatory system that will regulate the economy in the most efficient, timely and cost-effective manner. It is also consistent with provincial and territorial measures to reduce regulatory burden and red tape.

Common Securities Regulator

A change to Canada's securities regulatory structure would provide a unique opportunity to foster movement toward proportionate, more principles-based regulation. The fragmented nature of the Canadian regulatory structure impedes such development because while there may be agreement among jurisdictions on broad principles, there continue to be 13 different regulators, which are accountable to 13 different governments, to interpret and enforce the principles.

Over the years, numerous studies, analyses and commentary in Canada and internationally have made clear that the fragmented structure of securities regulation hurts the ability of Canadian firms to raise money. For example, a recent Canadian Bankers Association study concluded that issuers seeking to raise less than $10 million had issuing costs increase by 7.5 per cent for each additional jurisdiction in which funds were sought.

In rapidly evolving, intensely competitive global capital markets, Canada simply cannot afford 13 securities acts and securities regulators. Currently, Canada is the only jurisdiction not represented by a national regulator in the International Organization of Securities Commissions. In order to remain competitive and fully engaged internationally, Canada must act now and move towards a common securities regulator.

A common securities regulator would have one set of principles, supplemented by one set of rules and it would levy one set of fees. It would cut red tape and reduce costs for market participants. The benefits of a common securities regulator would also include clearer accountability and more responsive decision making in a rapidly evolving capital market, strengthened capacity for enforcement, and a stronger voice internationally.

Canada's New Government has made it clear that it wishes for Canada a *common* securities regulator, not a *federal* one. It envisages a regulator that gives an equal voice to all participating jurisdictions, not one dominated by any one region. At present, all provinces effectively allow control of the national market by the Ontario Securities Commission, which regulates over 80 per cent of Canada's total listed market capitalization by virtue of the fact that the senior equities exchange (the TSX) is subject to the Commission's oversight. A common securities regulator would rebalance the governance of the Canadian framework while maintaining responsiveness to all parts of the market. It would be based on the willing participation of provinces and territories that recognize benefits for their investors and businesses as well as for the Canadian economy more broadly.

A critical contribution to the national debate was made by the Crawford Panel. The panel proposed a "made-in-Canada" model of collaborative securities regulation that treats each participating jurisdiction as an equal. Its governance structure responds to regional needs and comprises:

- A Council of Ministers that provides government oversight over securities regulation.
- A single Canadian Securities Act to be adopted by all participating jurisdictions, including the federal government.

- A common securities regulator with regional offices located where expertise in certain sectors already exists, that would become "centres of excellence."
- A separate Canadian Securities Tribunal that conducts hearings and determines penalties for breach of securities laws.

A common securities regulator would build on progress realized under the "passport" system, overseen by the Council of Ministers of Securities Regulation, and the initiatives of the Canadian Securities Administrators to harmonize and streamline securities regulation.

The Minister of Finance invites provincial and territorial colleagues to come together now to establish a common securities regulator that administers proportionate, more principles-based regulation.

Modern Legal Framework

Efficient capital markets require a modern legal framework for financial transactions. This framework must provide issuers, investors and other parties to a transaction with clear rights and obligations. It must also keep up with international standards, advances in business practices, and evolving types of financial instruments.

The use of financial contracts (e.g. derivatives and securities financing transactions) has become an integral part of the risk management strategy for many Canadian businesses. Growth in both exchange-traded and over-the-counter derivatives markets has been strong in recent years. The annual compound growth rate of total derivative contracts traded on the Montréal Exchange reached 26 per cent over the last five years, with a 41-per-cent increase in 2006 alone.[3]

Financial contracts are routinely collateralized, which provides market participants access to larger and less costly credit lines and increases the pool of counterparties able to offer competitive terms.

The plan proposes to resolve current legal uncertainties about the ability of financial creditors to realize in a timely manner on collateral supporting financial contracts, in the event of bankruptcy or insolvency of their counterparty.

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3 See www.m-x.ca/f_comm_press_en/01-07_en.pdf.

Changes have been made to similar bankruptcy and insolvency provisions in the United States and the European Union. These changes have reduced risk for participants in those markets. Canada needs to modernize insolvency and bankruptcy laws and match the protections in other jurisdictions, to support trading in Canadian capital markets. This modernization would also enhance the competitiveness of Canadian banks when new global rules on capital requirements take effect in November 2007.[4]

Canadian capital markets and investors will also benefit from modernized securities transfer law. Securities transfer law concerns the rights of an investor in a security and governs how an investor may hold and transfer securities. An investor may hold a security directly or indirectly. In most Canadian jurisdictions, the framework operates as if an investor holds a security directly, even though it is far more common for a security to be held indirectly through a network of intermediaries (e.g. brokers, financial institutions, clearing agencies), but this is starting to change. A number of provinces have taken action to ensure that their statutes provide a sound legal foundation for indirect holdings, to complement the existing rules for direct holdings. This has been achieved through the introduction of new uniform securities transfer acts that are based on a model act drafted by a Canadian Securities Administrators-led task force.

Canada's New Government supports the provinces' efforts to implement modernized, uniform securities transfer law. To this end, the plan proposes to review securities transfer provisions in federal statutes to ensure they support current domestic and international market practices, and complement provincial efforts to develop a harmonized and seamless legislative regime governing the transfer of securities in Canada. As a first step, the Department of Finance will issue shortly a consultation paper to seek stakeholders' views.

4 The requirements of the Basel II Capital Accord are focusing banks on collateral arrangements and the legal regimes that govern them. Under these arrangements, banks will only be entitled to capital relief with respect to the collateral they hold if they have the right to liquidate the collateral "in a timely manner."

International financial institutions and organizations are also affected by the legal frameworks that govern the global capital markets in which they participate. The Bank for International Settlements (BIS) plays a valuable role in enhancing global financial stability and providing financial and intermediary services to central banks. It is important that the BIS be able to carry out its mandate without undue legal risks. The Government proposes to strengthen the immunities of the BIS in Canada, similar to those offered to other international financial institutions.

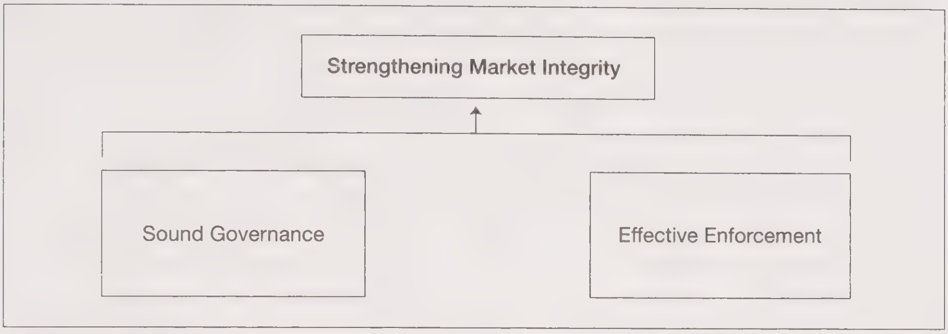
As noted in *Advantage Canada*, the Government is also committed to ensuring that the regulatory framework for financial institutions remains responsive to domestic and global developments, supported by effective sunset clauses in the financial institutions statutes.

Proposal:

Canada's New Government will:

- Work with provinces and territories to establish targets and timelines for adopting a new approach to securities regulation that:
  - Is based on clearly enunciated and sound principles.
  - Is tailored to the unique makeup of Canada's capital markets, with both Canada-based global corporations and a large number of small and medium-sized issuers.
  - Reduces administrative cost and paper burdens.
  - Improves investor protection.
  - Is delivered by a common securities regulator governed along the lines set out by the Crawford Panel.
- Modernize bankruptcy and insolvency rules to ensure full protection for collateral arrangements supporting financial contracts.
- Modernize securities transfer provisions in federal legislation in a manner that complements provincial efforts to develop a harmonized and seamless regime governing the transfer of securities in Canada. As a first step in this process, the Department of Finance will issue shortly a consultation paper.

Strengthening Market Integrity



Market integrity is critical to protect investors and promote healthy capital markets. It requires effective regulation, sound governance and strong enforcement. Sound governance ensures that invested funds are managed in the best possible ways and reduces the possibility of fraud. But even the best laws and regulations are effective only when they are enforced in a consistent and timely fashion. It is particularly important that strong enforcement be visible to investors, as this perception adds confidence and encourages participation in our markets.

Sound Governance

In Canada, governments, regulators and market participants have taken steps to improve financial reporting and disclosure to investors, enhance the quality of the audit process and strengthen corporate governance and management accountability. Measures have included:

- Establishing the Canadian Public Accountability Board to review the practices of public company auditors.
- Introducing new auditor independence standards.
- Adopting new requirements applicable to public company audit committees and the certification of financial statements.
- Implementing new corporate governance measures for public companies.

These reforms involved a wide range of participants, including the Canadian Securities Administrators. Special attention was paid to the unique features of Canadian capital markets. In particular, new requirements reflected considerations of costs to market participants, which in many instances resulted in a more flexible approach being taken with respect to Canada's smaller public issuers, as advocated in this plan.

Current ongoing initiatives include proposals dealing with management certification of internal control over financial reporting (Canada's counterpart to the U.S. Sarbanes-Oxley Act, Section 404) and the move from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards. Similarly, the Canadian Securities Administrators recently proposed amendments to their policy on reporting by income trusts. Canada's New Government supports informed disclosure, accuracy and consistency in reporting in the income trust sector, which is in the best interest of the investing public.

It is critical that Canada remain at the forefront of best governance practices. The global reputation of firms and of Canadian capital markets will be shaped in large measure by how well market participants respond to this ongoing obligation.

Effective Enforcement

To foster investor confidence and further attract domestic and foreign capital, Canada's governments, securities regulators and self-regulatory organizations must work together to bolster enforcement in Canadian capital markets. Effective enforcement entails coordination among authorities, an appropriate choice of administrative, civil and criminal remedies, and timely investigation and prosecution of capital market infractions.

In 2003, the federal government adopted a coordinated national approach to strengthen the investigation and prosecution of serious Criminal Code corporate fraud and market illegality. It allocated $30 million per year for the creation of Integrated Market Enforcement Teams (IMETs), led by the Royal Canadian Mounted Police (RCMP), in Canada's major financial centres.

The IMET approach, which brings together police, legal advisors, forensic accountants and market experts in integrated investigative teams, is sound. However, results to date suggest room for improvement. For example, investigations take longer than originally targeted. The Allen Task Force made a number of recommendations to improve the investigation and prosecution of capital market crime in Canada, stressing the need for:

- A renewed commitment to ensuring that the IMETs attract and retain the best specialized expertise to investigate complex capital market offences.
- A national capital market enforcement strategy bringing together all partners to ensure the effective use of resources, and the development and deployment of expert skill and knowledge across the country.

As discussed above, Canada's New Government believes that a common securities regulator would significantly strengthen capital market enforcement. It would focus accountability and conribute to the integration of the full range of enforcement efforts. A separate securities tribunal to adjudicate securities law disputes, as recommended by the Crawford Panel, could also play a significant, positive role by enhancing the independence and the accountability of the enforcement process.

The fight against capital market fraud and white-collar crime is a priority for Canada's New Government. To this end, the Government will appoint a senior expert advisor to the RCMP to help develop and guide the implementation of a plan to improve the effectiveness of the IMETs. This will include initiating concrete steps to enable the IMETs to attract and retain the best-qualified police and other expert resources, strengthen coordination of the program on a national basis and enhance collaboration with provincial authorities. As these improvements are made, the Government is prepared to supplement substantially the resources of the IMETs to achieve more effective and timely investigations.

In addition, Canada's New Government is clarifying the mandate of the IMETs to ensure that appropriate attention is given to the full range of cases that may damage investor confidence or economic stability in Canada. This includes fraud involving investment funds and cases that are of regional significance.[5]

Finally, Canada's New Government will work with provincial governments and regulators to improve the conduct of investigations and prosecutions and reduce administrative obstacles to timely action. In particular, the Government will fully support the federal-provincial working group of police, securities regulators and prosecutors that is reviewing ways to improve enforcement and that will report to Ministers responsible for Justice in the fall of 2007.

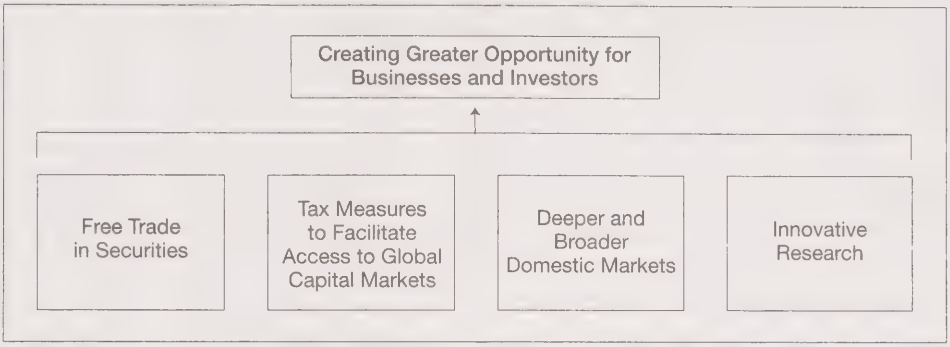
Proposal:

Canada's New Government will:

- Appoint a senior expert advisor to the RCMP to help develop and guide the implementation of a plan to improve the effectiveness of the IMETs, including concrete initiatives to:
  - Attract and retain the best-qualified police and other expert resources to conduct and support investigations into criminal capital market offences.
  - Strengthen the central coordination of the IMETs to guide the setting of priorities and the allocation of resources nationally.
  - Improve coordination between the IMETs, securities regulators and provincial Crown prosecutors, for example through joint consultative groups in each IMETs locale (Vancouver, Calgary, Toronto and Montréal).
- Once a plan is established and the RCMP is ready to move forward, allocate substantial additional resources to the IMETs to achieve more effective and timely investigations.
- Widen the types of cases that the IMETs can investigate to include those involving investment funds and cases of regional significance where these cases threaten investor confidence or economic stability in Canada.
- Continue to work in the federal-provincial working group of police, securities regulators and prosecutors that is reviewing ways to improve enforcement and will report to Ministers responsible for Justice in the fall of 2007.

5 The original mandate of the IMETs was: "To investigate serious *Criminal Code* capital markets fraud offences that are of national significance and involve actions of publicly-traded companies with sufficient market capitalization to pose a genuine threat to investor confidence and economic stability in Canada."

Creating Greater Opportunity for Businesses and Investors



An essential element of the plan is broadening opportunities for those who need capital and those who have money to invest. Governments and regulators can take measures to improve access to global capital markets and the effective functioning of domestic securities markets.

Free Trade in Securities

Over the past three decades, capital markets have become increasingly globalized, lowering volatility and cost of capital while providing diversification to investors. The process is not yet complete, and important barriers remain even among the most developed markets.

Canada is spearheading discussions to eliminate barriers to free trade in securities. Bilateral discussions are being pursued with the United States under the Security and Prosperity Partnership. Canada's New Government has also initiated discussions in the broader G7 forum. At their recent meeting in Essen, Germany on February 9–10, G7 Finance Ministers committed to further liberalize cross-border capital markets by exploring "… free trade in securities based on mutual recognition of regulatory regimes."

Through the Multijurisdictional Disclosure System (MJDS), Canada and the United States already practise mutual recognition of the disclosure requirements for qualifying companies extending their securities offerings to each other's capital markets. Canada's New Government proposes to build on the success of the MJDS in increasing the efficiency of cross-border access to capital for issuers by extending mutual recognition to exchanges and brokers, founded on a shared commitment to high standards of investor protection.

Under current rules, a number of regulatory barriers impede the free flow of capital, especially cross-border securities trading, adding distortions and costs. Further liberalization of global capital markets based on mutual recognition of the regulatory regimes governing securities would allow:

- Canadian investors to directly access securities listed on foreign exchanges through a Canadian or a foreign broker, where the foreign exchange or the foreign broker is recognized by Canadian regulators as being regulated in an acceptable manner for investor protection.
- Foreign investors in all participating jurisdictions to invest directly in the securities listed on Canadian exchanges such as the TSX and TSX Venture Exchange through their domestic broker or a Canadian broker.

Effective investor protection would be at the core of any possible framework, as would legal and information-sharing arrangements that support effective enforcement and redress. Under mutual recognition, the laws of the jurisdiction in which the exchange is located would protect investors. Exchanges and brokers would be governed by the laws in their home jurisdiction and issuers by the laws of the jurisdiction in which their securities are listed. Securities regulators in the various jurisdictions would be active participants in the development and implementation of agreements under the new framework.

Free trade in securities would raise diversification opportunities and returns for investors. Competition between market participants (such as stock exchanges and brokers) would increase efficiency and lower investment and trading costs, resulting in lower capital costs, and encourage economic growth.

To move free trade in securities forward, collective action will be required in Canada among governments, provincial securities commissions, self-regulatory organizations and market participants. Canada's New Government will continue to advance free trade in securities bilaterally with the United States and in the G7, and will lead the process of domestic engagement necessary to make this idea a reality.

Tax Measures to Facilitate Access to Global Capital Markets

Canada's New Government is also proposing to lower tax barriers for both domestic investors in international markets and international investors in Canadian companies.

Representatives of Canada and the United States have agreed in principle to update our tax treaty. The revised treaty will create a more competitive lending market in Canada and lower barriers to the flow of capital between our countries. This will include a complete exemption from withholding tax in respect of cross-border interest payments between the two countries as well as the extension of treaty benefits to limited liability companies commonly used by U.S. venture capital firms. When the revised treaty comes into force, the Government also proposes eliminating Canadian withholding tax on interest paid to all arm's-length non-residents, further expanding funding opportunities for investment.

Second, the Government proposes to lower tax barriers to international investment by updating the concept of "prescribed stock exchange" under the Income Tax Act. Currently, securities listed on a prescribed stock exchange benefit from a number of tax provisions, such as qualifying to be held in registered retirement savings plans, exemption from a capital gains tax withholding procedure that would otherwise apply when non-residents dispose of such securities, and eligibility for special tax rules that apply to securities lending.

Under the proposal, a tiered classification of exchanges better tailored to the specific objectives of the Income Tax Act in the above-noted areas will be introduced. The new system will enhance responsiveness to global market and regulatory developments, including the creation of new exchanges and the amalgamation or reorganization of exchanges under a new name. Proposed tax changes are described further in Annex 5 of *The Budget Plan*.

Deeper and Broader Domestic Markets

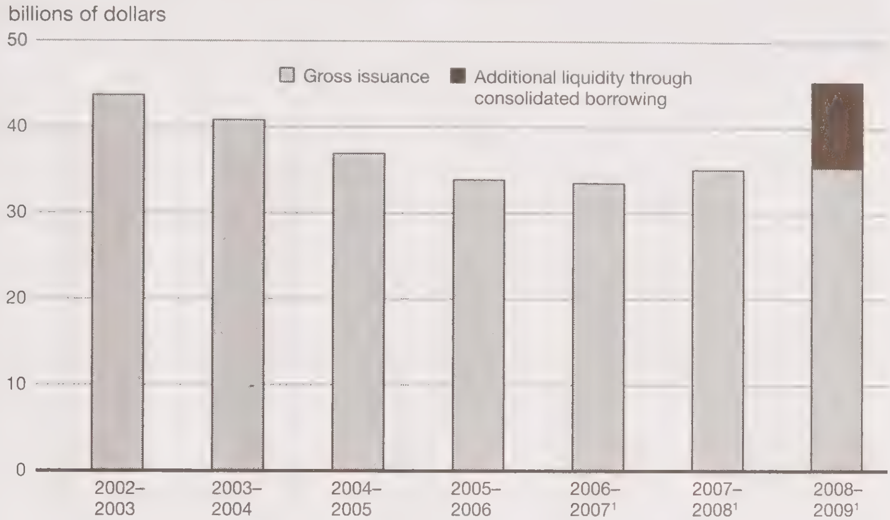
Canada must have well-functioning, competitive and diversified domestic capital markets to attract offshore borrowers and investors and to provide a full range of Canadian-dollar-denominated financing and investment opportunities to Canadian individuals and institutions.

Canada's financial markets are well developed, providing a wide range of investment choices. There are nonetheless changes to government policy and regulation that could enhance liquidity and efficiency and extend the range of available investment instruments.

Enhancing the Government Securities Market

Government of Canada securities anchor the fixed-income market by providing a risk-free pricing and hedging benchmark for debt securities issued by other levels of government and corporations, interest rate derivatives and repurchase agreements. Declining government borrowing needs in an era of balanced budgets poses challenges to the maintenance of a well-functioning market. Currently, the Government borrows for its own operational needs alongside a number of Crown corporations and guaranteed entities, which borrow separately in capital markets. Canada's New Government is proposing to consolidate the borrowings of the Business Development Bank of Canada, Canada Mortgage and Housing Corporation (not including the Canada Housing Trust), and Farm Credit Canada with the Government's own debt program. This measure will reduce overall borrowings costs by up to $90 million over five years, while enhancing the liquidity of the government bond market by up to 30 per cent (see Annex 3 of *The Budget Plan*). To support this initiative, amendments to the Government of Canada's legislative authority to borrow will be proposed (see Chapter 7 of *The Budget Plan*).

Chart 4
Government of Canada Bond Program



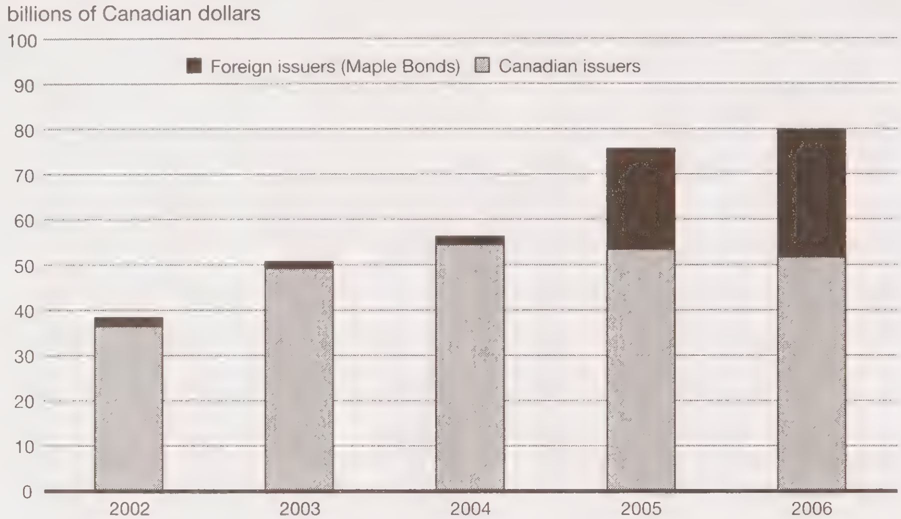
[1] Estimate for 2006–07, projection for 2007–08 and 2008–09.
Sources: Bank of Canada; Department of Finance.

Expanding the Range of Instruments for Canadian Investors

The removal of the foreign property rule in 2005 has sharply increased the investment options available to Canadians. For example, the measure has fostered the development of the Maple Bond market (Canadian-dollar bonds issued by foreign entities in Canada), providing additional diversity to the fixed-income market. However, to date, Maple Bonds have been sold as "private placements" to institutional investors, rather than as public offerings under prospectus, partly to minimize securities regulatory costs. Maple Bonds are thus not generally available to retail investors. Common, principles-based securities regulation could contribute to more public issuance of Maple Bonds by reducing regulatory costs. Also, under current income tax rules, Maple Bonds issued by quasi-government entities, subnational governments and unlisted companies, irrespective of their credit quality, are not eligible to be held in an RRSP. Canada's New Government proposes to amend the Income Tax Act to expand the list of RRSP qualified investments to include most investment-grade debt and publicly-listed securities. This proposed tax change is described in detail in Annex 5 of *The Budget Plan*.

Chart 5

Gross Corporate Bond Issuance in Canada



Sources: Bank of Canada; Bloomberg.

Canada's governments must also accommodate and support the development of new private sector investment opportunities that bring capital to where it is most needed, notably infrastructure. The establishment in Budget 2007 of a national fund for public-private partnership (P3) and the creation of a new federal office to help execute P3 projects will encourage the development of a P3 market in Canada. These initiatives will provide opportunities for Canadian pension funds and other investors to pursue in Canada long-term investments with competitive, stable returns.

Developing New Markets

Emissions trading will be an important component of a market-driven approach to reducing greenhouse gas (GHG) emissions and air pollutants (i.e. nitrogen oxides and sulphur dioxide). Well-designed emissions-trading systems can reduce overall costs associated with regulatory compliance by allowing firms with high costs of emissions abatement to pay firms with lower costs to reduce emissions on their behalf. The creation of an emissions-trading system in Canada could be beneficial for Canadian markets and provide business opportunities for our exchanges.

The commitment of Canada's New Government to significantly reduce GHG emissions and air pollutants over the medium and longer term has the potential to make Canada a leader in emissions trading. Recognizing this opportunity, Canada's exchanges have been positioning themselves to launch trading when the regulatory framework is finalized.

Innovative Research

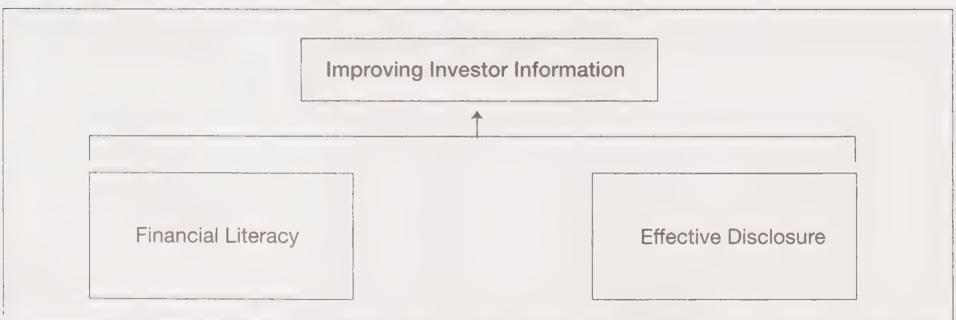
Advantage Canada highlighted the need for developing skills and excellence in research to support the development of the best-educated, most-skilled and most flexible workforce in the world. In addition to highly skilled practitioners, a leading-edge capital markets system requires university researchers to continually advance the study of capital markets as this forms the basis for training and ongoing professional development of practitioners. The new resources provided to the Social Sciences and Humanities Research Council of Canada for targeted research in the fields of management, business and finance (see Chapter 5 of *The Budget Plan*) will contribute to the development of the skilled and experienced finance professionals needed to build a world-class capital markets environment.

Proposal:

Canada's New Government will:

- Continue to advance free trade in securities bilaterally with the United States and in the G7, and lead the process of domestic engagement necessary to make this idea a reality.
- Update our tax treaty with the United States to lower tax barriers to the flow of capital between our countries.
- Amend tax rules affecting investment in securities listed on foreign stock exchanges to improve responsiveness to market and regulatory developments and lower a tax barrier on non-residents who invest in Canadian companies listed on an exchange abroad.
- Consolidate the debt issuance of some of the major Crown corporations (Canada Mortgage and Housing Corporation, Farm Credit Canada, Business Development Bank of Canada) with the Government's debt program.
- Amend the qualified investment rules under the Income Tax Act to expand the range of debt and publicly-listed securities that can be held by retail investors in an RRSP.
- Develop the necessary policy and regulatory framework to facilitate the successful launch of emissions-trading markets in Canada.
- Support university research related to capital markets.

Improving Investor Information



As they pursue financial goals—such as saving for education or planning their retirement—Canadians face decisions that require careful organization and informed choices. The best approach to promote investor interests is to ensure that they have the financial literacy and information they need to make sound decisions.

Financial Literacy

The ability to make informed financial decisions is an essential skill that should be developed early in life. As consumers increasingly manage their own financial affairs, the Canadian financial landscape has become more complex, with an ever-expanding range of products, service providers and delivery channels. The variety of investor education efforts offered by the private sector, regulators and non-profit organizations demonstrates that this issue is not confined to one group or community; it is a need faced by Canadians from all walks of life.

Governments are active in this area. The Government of British Columbia recently set an example by making financial literacy instruction part of the compulsory curriculum in high school. At the federal level, the Financial Consumer Agency of Canada (FCAC) is mandated with fostering an understanding of financial services and has made a number of resources available on its website and in publications.

The Joint Forum of Financial Market Regulators,[6] with the participation of the FCAC, is completing an inventory of existing investor education resources and content, and plans to review the efforts of other jurisdictions on the issue of investor information and education, with the goal of developing recommendations for improvements in investor information and education in Canada.

More recently, a group of high-profile volunteers from the financial sector formed a national steering committee to provide momentum to an agenda that supports financial literacy.

Since it was established by the federal government in 2001, the FCAC has steadily increased its expertise in investor education and the tools and information for consumers that it makes available. The FCAC is ready and well placed to support financial literacy efforts across the country.

There is a particular need for educational materials, especially for young people. All organizations working in financial literacy could also benefit from better sharing of information and instructional materials. A survey being conducted by the federal government on the financial literacy of Canadians will assist in identifying needs and guide future investor

[6] The Joint Forum comprises the Canadian Securities Administrators, the Canadian Council of Insurance Regulators and the Canadian Association of Pension Supervisory Authorities.

education initiatives. As considerable work is already underway in many other organizations, additional federal efforts must be carefully designed to support or add to existing programs, not displace them.

Effective Disclosure

To protect investors' interests, issuers of financial products and intermediaries must disclose the information that investors need to make informed choices. Plain language, not fine print, must convey the key information. Regulatory requirements must be principles-based and not cumbersome to interpret and apply—a key consideration in a market that is characterized by the frequent introduction of new products.

The Allen Task Force recommended changes to disclosure to enhance the usefulness of the information disclosed. In making its recommendation, it noted that if disclosure requirements are too detailed, the volume of information presented results in information overload.[7] Mindful of such challenges, the Joint Forum of Financial Market Regulators is developing an integrated disclosure system for segregated funds and mutual funds that will deliver important information in a two page, user-friendly format.

Canada's financial services sector is dynamic, constantly introducing new products and services. In recent years, banks have introduced principal protected notes. These notes guarantee the invested principal and offer returns that are linked through formulas to returns on an underlying investment product that can range from a relatively straightforward basket of equities to less transparent investments such as hedge funds. The complexity of such products can make it difficult for the average retail investor to fully understand the risks, fees and potential returns. Concerns to this effect were set out by the Canadian Securities Administrators in an advisory issued in 2006.[8]

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[7] The Task Force to Modernize Securities Legislation in Canada, *Canada Steps Up*, Final Report, pp. 55-57.

[8] Canadian Securities Administrators, CSA Notice 46-303, July 2006.

When principal protected notes were first introduced by banks, the Government instituted detailed rules-based regulations, the Index-linked Deposits Interest Disclosure Regulations. However, as these products grow more varied and complex, the old disclosure rules are no longer adequate.

The Government will soon release for comment principles-based regulations for banks that issue these notes to ensure better disclosure for investors. The regulations will ensure that consumers are informed of the fees, returns, risks, and cancellation and redemption rights associated with principal protected notes. A principle stating that this information be clearly disclosed by qualified individuals will ensure that investors have the information they need to make more informed investment decisions. In addition, the regulations will require disclosure after purchase to aid investors in monitoring and tracking their investments.

Proposal:

Canada's New Government will:

- Fund the FCAC to develop and share instructional materials for financial literacy education, especially for young people.
- Fund the FCAC to facilitate the sharing of information and instructional materials among financial education providers.
- Introduce a new principles-based disclosure regime for bank products with complex features (principal protected notes).